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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-243

UNITED STATES OF AMERICA,

Appellant,

v.

E. M. and B. L. DARUSMONT,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

MOTION OF APPELLEES E. M. and B. L. DARUSMONT TO AFFIRM

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QUESTION PRESENTED

Whether Section 56 of the Internal Revenue Code of 1954, as amended by Section 301 of the Tax Reform Act of 1976, commonly referred to as the "minimum tax on items of tax preference", as applied retroactively to Appellees E. M. and B. L. Darusmont in 1976, denied Appellees due process of law under the Fifth Amendment to the Constitution of the United States.

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MOTION TO AFFIRM

Appellees E. M. and B. L. Darusmont, pursuant to Rule 16.1(d) of the Rules of the Supreme Court of the United States, respectfully move that the final judgment of the District Court be affirmed on the ground that the judgment is so obviously correct as to warrant no further review by this Court.

OPINION BELOW

The findings of fact and conclusions of law of the District Court, which are not officially reported, are set forth in Appendix A of Appellant's jurisdictional statement. The judgment of the District Court, which is not officially reported, is set forth in Appendix B of Appellant's jurisdictional statement. These appendices, therefore, are not unnecessarily duplicated here.

JURISDICTION

The jurisdictional requisites are adequately set forth in Appellant's jurisdictional statement.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954, Sections 56 and 57 as amended by Section 301 of the Tax Reform Act of 1976, and, Section 301(g)(1) of the Tax Reform Act of 1976, are set forth in Appendix D of Appellant's jurisdictional statement.

CONSTITUTIONAL PROVISIONS INVOLVED

Amendment V

No person shall . . . be deprived of . . . property, without due process of law; . . ..

STATEMENT OF THE CASE

In April, 1976, Appellee E. M. Darusmont[1] was notified by his employer that he was to be transferred from Houston, Texas

[1] "Appellee" refers to E. M. Darusmont. B. L. Darusmont is a party to this action solely because she filed a joint return with her husband for 1976.

to Bakersfield, California (Darusmont Dep. 7-8). As a result, Appellee decided to sell his Houston triplex, consisting of a three-unit house in which he occupied one unit and rented the remaining two units (Darusmont Dep. 6-8).

In May, 1976, Appellee retained the firm of Coldwell, Banker & Company, a real estate firm well-known in the Western United States and listed on the New York Stock Exchange (referred to herein as "Coldwell Banker") to list the property and to advise him on the best way to sell the property (Darusmont Dep. 6-8).

Representatives of Coldwell Banker met with Appellee and suggested the following three ways to structure the sale as alternatives to selling the triplex outright for cash: (1) convert the three apartments to condominiums, and then sell Appellee's unit outright and the other two units on the installment basis with 30% of the purchase price down and the balance payable over five years; (2) sell the triplex as one unit on the installment basis with 30% of the purchase price down and the balance payable over five years; or (3) sell the triplex as one unit on the installment basis with 30% of the purchase price down and the balance payable over twenty-five to thirty years (Darusmont Dep. 8-11; Finding of Fact No. 1).

In connection with structuring the sale, Appellee and Coldwell Banker discussed the tax consequences of each of the alternatives, including capital gains taxes, the installment method of reporting, and the possibility of deferring a portion of the capital gain by purchasing another home in Bakersfield, California (Darusmont Dep. 8-11, 16-17; Complaint; Finding of Fact No. 1).

Appellee also discussed the tax consequences of the various alternative methods of structuring the sale with friends and co-workers (Finding of Fact No. 1).

Neither Coldwell Banker nor any of the friends and co-workers with whom Appellee discussed the tax consequences of the various methods of structuring the sale discussed with

Appellee whether the minimum tax on items of tax preference, as the law then existed, would apply to any of the methods suggested for structuring the proposed sale of the triplex (Darusmont Dep. 12-13, 16-17).

Appellee, after considering the ramifications of the various alternative methods of structuring the sale which were suggested to him, including practical considerations and the tax implications under the law as it then existed, and after computing what he projected to be his income tax liability, decided to sell the triplex outright. On July 15, 1976, Appellee sold the triplex as one unit, outright for cash (Darusmont Dep. 8-13, 16-19; Complaint; Finding of Fact No. 1).

Under the provisions of the law governing the minimum tax on items of tax preference, as in effect in May, 1976, when Appellee structured the proposed sale with the advice of Coldwell Banker and that of friends and co-workers, and as in effect on July 15, 1976, when Appellee sold the triplex outright, Appellee would not have owed any minimum tax in connection with the sale of the triplex (Finding of Fact No. 2).

On October 4, 1976, the President signed the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520. Section 301 of the Tax Reform Act reduced the amount of the exemption to $10,000 or one-half of the regular tax deduction, whichever is greater, which replaced the $30,000 prior exemption and deduction for regular taxes, and, increased the rate of the minimum tax from 10% to 15%. Section 301(g)(1) of the Tax Reform Act of 1976 made these changes to the minimum tax effective for taxable years beginning after December 31, 1975, that is, retroactive to January 1, 1976.

Had Appellee been aware of the changes to the minimum tax on items of tax preference made by the Tax Reform Act of 1976, subsequent to the sale but retroactive to January 1, 1976, he could have structured the sale of the triplex to completely avoid the minimum tax (Finding of Fact No. 4; Complaint).

Appellee regularly prepared his own federal income tax return, a practice he continued in 1976 (Darusmont Dep. 19).

However, because of the complications of the sale of the triplex and moving from Houston, Texas to Bakersfield, California, in March, 1977, Appellee retained a Certified Public Accountant in Bakersfield, California to review the return prior to filing for errors, omissions or potential tax savings (Darusmont Dep. 15-19).

After reviewing the return, the accountant informed Appellee that in preparing his return he had overlooked the minimum tax (Darusmont Dep. Exhibit A). The accountant informed Appellee that under the law as originally enacted and in force at the time of the sale, no minimum tax would have been due because of the amount of the exemption. However, the changes in the minimum tax enacted in October, 1976 and made retroactive to January 1, 1976, increased Appellee's income tax liability by $2,280 (Darusmont Dep. Exhibit A).

Appellee had no knowledge of the changes to the minimum tax on items of tax preference made by the Tax Reform Act of 1976 prior to having the "pencil draft" of his 1976 return reviewed by the accountant, except that he was casually aware from newspaper reports of the existence of the Tax Reform Act of 1976 (Darusmont Dep. 12).

Appellee timely filed a joint 1976 federal income tax return with his spouse showing a tax liability of $25,384, including the $2,280 in minimum tax, and timely paid this amount (Complaint). Appellee's Claim For Refund of $2,280 of minimum tax was denied, and he subsequently instituted the suit for refund which is the subject of this appeal.

ARGUMENT

THE RETROACTIVE APPLICATION OF THE MINIMUM TAX ON ITEMS OF TAX PREFERENCE TO APPELLEE IN 1976 WAS SO HARSH AND OPPRESSIVE AS TO DENY APPELLEE DUE PROCESS OF LAW

This Court has held that a retroactive income tax statute does not violate the "due process" clause of the Constitution *per se*. *See Milliken v. United States,* 283 U.S. 15 (1931). However, under certain circumstances, retroactive tax statutes have been held to deny due process of law as applied.

To determine whether or not a particular retroactive tax statute, as applied, denies due process, this Court has stated:

> In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so *harsh and oppressive* as to transgress the constitutional limitation. *Welch v. Henry,* 305 U.S. 134 at 147 (1938) (emphasis added).

This Court and lower courts have developed three tests for determining whether or not a particular retroactive tax is so harsh and oppressive as to be a denial of due process, each of which has formed the basis of decision at least once that a particular retroactive tax was unconstitutional as applied. These three tests are:

1. Whether the taxpayer could have altered his behavior to avoid the retroactive tax if the nature or amount of the tax could reasonably have been anticipated by the taxpayer at the time the taxpayer engaged in the transaction;

2. Whether the taxpayer had notice of the tax when he engaged in the transaction; and

3. Whether the tax is a new tax, not merely an increase in the rate of an existing income tax.

1. APPELLEE COULD HAVE STRUCTURED THE SALE OF THE TRIPLEX TO AVOID THE MINIMUM TAX IF THE CHANGES TO THE MINIMUM TAX MADE RETROACTIVELY BY THE TAX REFORM ACT OF 1976 COULD REASONABLY HAVE BEEN ANTICIPATED BY APPELLEE PRIOR TO THE SALE.

The concept that certain retroactively imposed taxes arbitrarily impinge on voluntary behavior is rooted in the gift tax cases *Blodgett v. Holden,* 275 U.S. 142 (1927), modified, 276 U.S. 594 (1928), and *Untermyer v. Anderson,* 276 U.S. 440 (1928).

As stated by this Court in *Welch* in reference to these cases:

> In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular *voluntary act* which the statute later made the taxable event [citations]. *Since, in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process. Welch v. Henry, supra* at 147 (emphasis added).

In *Blodgett,* the Revenue Act of 1924, which was enacted on June 2, 1924, imposed a tax on all gifts made during the calendar year 1924. The taxpayer argued that the statute was unconstitutional as applied to gifts he made in January, 1924, prior to enactment of the statute. Due to an equal split in the opinion of the eight justices of this Court who considered the case, the Court did not rule on the constitutionality of the statute. However, four justices stated:

> As to the gifts which Blodgett made during January, 1924, we think the challenged enactment is arbitrary and for that

> reason invalid. *It seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequences, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing. Blodgett v. Holden, supra* at 147 (emphasis added).

This view of *Blodgett* was subsequently adopted by a majority of the Court in its decision in *Untermyer, supra.*

Here, the outright sale of the triplex did not in fact subject Appellee to the minimum tax as it existed on the date of the sale. Subsequent to the sale, the Tax Reform Act of 1976 amended the minimum tax provisions retroactively to subject Appellee to the minimum tax in connection with the sale, a change in the tax laws which could not reasonably have been anticipated by Appellee at the time of the sale. If the changes to the minimum tax made by the Tax Reform Act of 1976 had been in effect at the time of the sale of the triplex or could have been anticipated, Appellee could have structured the sale so as to avoid the tax by selling the triplex on the installment basis.

Appellant apparently argues that since the evidence is conflicting as to whether Appellee actually relied in structuring the sale on the fact that the minimum tax as it then existed did not apply to the outright sale of the triplex, Appellee cannot now argue that he would have structured the sale to avoid the tax if he had been aware of it. The inference that Appellee would not have been aware of the new minimum tax law had it been in existence at the time of the sale cannot be drawn from the fact that Appellee may not have been aware of the minimum tax as it in fact existed at the time of the sale. If the changes to the minimum tax made by The Tax Reform Act of 1976 had been in effect at the time Appellee structured the sale, his advisors certainly would have called its existence to his attention since the effect of the changes, particularly the reduction in exemption, was to expose many more taxpayers and smaller transactions to the minimum tax than under the old law. Appellee, being a reasonably well-read layman, might very well have been personally aware of the changes.

In *Welch,* this Court, in upholding the retroactive imposition of an income tax on dividends by Wisconsin, stated:

> [T]here are . . . forms of taxation [other than gifts] whose retroactive imposition cannot be said to be similarly offensive, because their incidence is not on the voluntary act of the taxpayer . . . .
>
> [A] tax on the receipt of income is not comparable to a gift tax. We cannot assume that stockholders would refuse to receive corporate dividends even if they knew that their receipt would later be subjected to a new tax or to the increase of an old one. *Welch v. Henry, supra* at 147-148.

However, *Welch* is distinguishable from this case precisely because the incidence of the changes to the minimum tax made by the Tax Reform Act of 1976 did fall on the voluntary act of Appellee — the voluntary act of structuring the sale of the triplex so as to avoid the tax. As in the case of a gift, Appellee could have voluntarily altered his behavior to avoid the tax, an entirely different situation from the recipient of corporate dividends who, in effect, has no choice but to accept the dividends and pay whatever tax is imposed on such receipt.

Here, since Appellee could have freely chosen to structure the sale so as to avoid the minimum tax as amended by the Tax Reform Act of 1969, the retroactive imposition of the tax after Appellee's choice of a method to structure the sale, a choice which could have been and most probably would have been different had Appellee anticipated the tax, was arbitrary, harsh and oppressive.

2. APPELLEE DID NOT HAVE NOTICE OF THE RETROACTIVE CHANGES TO THE MINIMUM TAX WHEN HE SOLD THE TRIPLEX.

Here, although Appellee was casually aware of the existence of the Tax Reform Act of 1976, he had no actual notice of the proposed changes to the minimum tax which were subsequently enacted retroactively.

Appellant apparently argues that Appellee had *constructive* notice of the pending legislation as a result of certain Congressional Committee Reports, namely the House Ways and Means Committee Report on the House version of the bill, H.R. Rep. No. 94-658, 94th Cong. 1st Sess. (1975), issued in November, 1975, that is, in the calendar year prior to the year in which the transaction took place, and the Senate Finance Committee Report on the Senate version of the bill, S. Rep. No. 94-938, 94th Cong., 2d Sess. (1976), issued in June, 1976, that is, after Appellee had structured the sale in May, 1976.

Not only were these Reports issued months apart and in different calendar years, that is, in different fiscal periods, they each proposed different changes to the existing minimum tax. The House version proposed raising the minimum tax rate to 14% and reducing the exemption to a maximum of $20,000 and the deduction for regular income taxes to one-half of regular taxes, while the Senate proposed increasing the minimum tax rate to 15%, and reducing the exemption to the greater of $5,000 or the amount of the regular income tax liability, two divergent proposals eventually compromised in the Tax Reform Act of 1976 enacted in October, 1976.

It is untenable to require private individuals to follow proposed changes in the Internal Revenue Code through Congress, and, in fact this Court in *Untermyer* rejected this requirement. The government attempted to distinguish *Untermyer* from *Blodgett* on the ground that the gift in question was made three months after the Revenue Act of 1924 was passed, and while the Act was awaiting only the Conference Report, final Congressional approval and the signature of the President. In fact, the gift was made just twelve days before the Act was signed into law by the President. In rejecting the argument that the taxpayer had notice of the statute and in holding the Act unconstitutional as applied to gifts made prior to final enactment, this Court stated:

> The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage

> of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation and practical application of the statute and render impossible proper understanding of the burden intended to be imposed. *The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot forsee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken. Untermyer v. Anderson, supra* at 445-46 (emphasis added).

Further, this case is distinguishable from three instances in which a retroactive income tax was found to be constitutional on the basis that the taxpayer had notice of pending legislation. In all three cases, the taxpayer was a sophisticated investor, who, having *actual* notice of the pending legislation, attempted to take advantage of a "loophole" before it was closed through the mechanism of a regulatory tax.

In *United States v. Hudson,* 299 U.S. 498 (1937), the plaintiff-taxpayer sold certain futures contracts in silver in late May of 1934. On June 19, 1934, the Silver Purchase Act was passed and made retroactive to May 15, 1934 (a period of 35 days). The court, in upholding the retroactive application of the statute, noted as the basis for its decision, the following facts:

> For some months prior to [May 15] . . . there was strong pressure for legislation requiring increased acquisition and use of silver by the government, and several bills providing therefor were presented in the Senate and House of Representatives. On May 22 the President sent to Congress a message recommending legislation for increasing the amount of silver in our monetary stocks and further recommending the imposition of a tax of at least 50 per

> cent. on profits accruing from private dealing in silver. The bill which became the Silver Purchase Act was introduced May 23 in response to this message. *United States v. Hudson, supra* at 501. (footnote omitted).

The transactions in *Hudson* took place at the time and shortly after the bill was introduced in direct response to the President's message. The bill was enacted 28 days after it was introduced and was made *retroactive for only 35 days.* It is obvious that tax was meant to and did reach those investors who, having actual notice of the impending legislation, attempted to profit prior to enactment of the statute.

Two recent cases considered the retroactive application of the Interest Equalization Tax Act of 1964, *First National Bank in Dallas v. United States,* 420 F.2d 725 (Ct. Cl. 1970), *cert. denied,* 398 U.S. 950 (1970), and *Purvis v. United States,* 501 F.2d 311 (9th Cir. 1974), *cert. denied,* 420 U.S. 947 (1975).

As in *Hudson,* a public issue, well-known to those few affected taxpayers, was involved. In discussing the public nature of the issue, the *Purvis* court stated:

> [P]resident [Kennedy] in his message [to Congress proposing the tax] made it clear that *if the tax was to achieve its purpose,* it was essential that legislation creating the tax be made effective as of the date of the Presidential message—July 18, 1963. *Otherwise, a rush by investors to beat the deadline would serve to aggravate the problem and render the proposal self-defeating.*
>
> The President's message was well publicized in the newspapers and financial journals. The market in foreign securities was promptly affected. On the day of the message the Treasury Department issued documents giving details of the proposed tax. A 'Notice of Proposed Effective Date' with a description of the proposed Act was published in the Federal Register on August 16, 1963. The Act in substantially the form proposed by the President was signed into law September 2, 1964, with an effective

date of July 18, 1963. *Purvis v. United States, supra* at 312 (footnote omitted) (emphasis added).

In upholding the constitutionality of the Act, the Court of Claims in *First National Bank in Dallas* stated:

> Although the interest equalization tax would raise a not insignificant amount of revenue, it is clear that the primary purpose of the tax was regulatory—to limit the outflow of long-term capital from the United States, and thereby alleviate the United States balance of payments problem. The retroactive aspect of the tax, moreover, was no mere embellishment; indeed, that aspect was a necessary prerequisite to the effectuation of the regulatory purpose. For if the interest equalization tax had not been proposed and enacted with retroactive effect, a premium would have been placed upon the consummation of 'covered' transactions prior to the tax's enactment date. Far from relieving the balance of payments problem, such a prospect would have intolerably aggravated the problem. That the public purpose served by the procedures invoked at the time of, and prior to, enactment was of the highest order cannot seriously be questioned. *First National Bank in Dallas v. United States, supra* at 730-31.

The court in *Purvis* further stated:

> We conclude, as did the Court of Claims [in *First National Bank in Dallas*] that with the widespread notice given to the investing public it cannot be said that retroactive application of this tax was oppressive or harsh or confiscatory. With the undeniable need for retroactive application in general if the *purpose of the tax* was to be realized, it cannot be said that retroactive application of this tax was arbitrary or capricious. *Purvis v. United States, supra* at 314 (emphasis added).

As in *Hudson, First National Bank in Dallas,* and *Purvis,* there is some justification in imputing actual notice of pending retroactive legislation where an identifiable, sophisticated group of taxpayers is involved, where the proposed legislation received widespread publicity in the media and through professional channels such as brokerage houses, and where the retroactivity serves the regulatory purpose of the tax.

Here, to the contrary, with no media coverage or fanfare, the House Ways and Means Committee, in November, 1975, reported out its version of the proposed Tax Reform Act of 1975. Six months later, the Senate Committee presented its proposal, and almost a year later the President signed the compromise version of the Act. The minimum tax provisions were made retroactive for a period of nearly one year.

Further, the proposed changes to the minimum tax were not a regulatory measure aimed at an identifiable group of taxpayers for the purpose of closing a tax "loophole", despite the fact that they were ultimately included in a "Tax Reform Act". The pertinent legislative history indicates that the primary purpose of the various changes to the minimum tax incorporated into the Tax Reform Act of 1976 was to raise revenue by ensuring that a larger group of high income individuals pay at least some income taxes. *See* Staff of the Joint Committee on Taxation, 94th Cong. 2d Sess., *General Explanation of the Tax Reform Act of 1976* (Comm. Print 1976).

Even assuming that a taxpayer is required to be aware of pending legislation, how far back in time should a taxpayer be expected to be knowledgable of the public record? Certainly, Appellee submits, no further back than within the fiscal year during which the taxable transaction takes place. Yet, when Appellee structured the sale of the triplex in May, 1976, there had been no public report of any proposal to change the minimum tax law within that calendar year. As Appellant admits in its Jurisdictional Statement at page 10, it was not until June 10, 1976, when the Senate Finance Committee issued its

report that there had been any public record of the proposal in calendar year 1976. S. Rep. No. 94-938, 94th Cong., 2d Sess. (1976).

Here, since Appellee had no notice, either actual or constructive, of the retroactive changes to the minimum tax at the time he sold the triplex, the retroactive imposition of the tax after the sale was arbitrary, harsh and oppressive.

3. THE MINIMUM TAX AS AMENDED BY THE TAX REFORM ACT OF 1976 WAS A NEW TAX, AS TO APPELLEE, NOT MERELY AN INCREASE IN THE RATE OF AN EXISTING INCOME TAX.

In *Cohan v. Commissioner,* 39 F.2d 540 (2nd Cir. 1930), Judge Learned Hand stated:

> Nobody has a vested right in the rate of taxation, which may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset [citations]. . . . [I]t is no objection that upon occasion the result may disappoint reasonable anticipations. The injustice is no greater than if a man chance to make a profitable sale in the months before the general rates are retroactively changed. Such a one may indeed complain that, could he have foreseen the increase, he would have kept the transaction unliquidated, but it will not avail him; he must be prepared for such possibilities, the system being already in operation. *His is a different case from that of one who, when he takes action, has no reason to suppose that any transactions of the sort will be taxed at all. Cohan v. Commissioner, supra* at 545 (emphasis added).

Appellant argues that the changes made to the minimum tax by the Tax Reform Act of 1976 constituted merely a change in the income tax rates in effect at the time Appellee sold the triplex, and not a new tax.

To the contrary, the changes to the minimum tax made retroactively by the Tax Reform Act of 1976 imposed an entirely new tax as to Appellee on the sale of Appellee's property.

Congress has repeatedly stated that the minimum tax on tax preferences is a separate, distinct tax, computed separately and in addition to the regular income tax liability. For example, in its 1975 Report on proposed changes to the minimum tax, the House stated:

> [Y]our committee decided to keep the existing structure of the minimum tax, *which is in addition to regular tax liability,* . . . H.R. Rep. No. 94-658, 94th Cong., lst Sess. at 130 (1975) (emphasis added).

The provision of the 1976 Tax Reform Act changing the minimum tax reads as follows:

> (a) GENERAL RULE, — *In addition to the other taxes imposed by this chapter,* there is hereby imposed for each taxable year, . . . a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of—
>
> (1) $10,000, or
>
> (2) the regular tax deduction for the taxable year . . . Section 301(a), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, 1549 (emphasis added).

The provision of the Tax Reform Act changing the minimum tax also provides at Section 301(f):

> For purposes of section 21 of IRC of 1954, the Amendments [to the minimum tax] made by this section *shall not be treated as a change in a rate of tax.* Section 301(f), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, 1553 (emphasis added).

Although Section 21 merely provides a method of computing tax when the rate of tax has changed during the taxable year,

this provision of the Tax Reform Act is further indication that Congress did not intend the minimum tax on tax preferences to be a change in the rate of income tax, but rather a separate tax from regular income tax liability.

Further, not only does the statute state that the minimum tax is in addition to regular income tax liability, and, therefore, by definition, not merely an increase in rate, the method provided in the statute for computing the minimum tax makes it impossible to compute the two taxes without treating them as separate and distinct. The taxpayer computes the minimum tax by adding up his "tax preference" items and deducting therefrom the greater of $10,000 or one-half of his regular income tax liability for the year. Since a taxpayer cannot compute the minimum tax on tax preferences without first computing his regular income tax liability, the two taxes are necessarily separate and distinct.

Appellee became subject to this separate tax for the first time when the changes to the minimum tax made by the Tax Reform Act of 1976 were enacted retroactively. At the time of the sale of the triplex, an outright sale was not subject to any minimum tax. As a result of the large decrease in the allowable exemption imposed retroactively, the transaction became subject to the minimum tax for the first time.

Thus, the objectionable aspect of the retroactive imposition of the changes to the minimum tax made by the Tax Reform Act of 1976 as to Appellee is not the increase in rate of minimum tax from 10% to 15%, but the reduction of the exemption from $30,000 to the greater of $10,000 or one-half of the taxpayer's regular income tax liability, which subjected a whole new class of taxpayers to the minimum tax, including Appellee.

This case is distinguishable, on this ground, from *Buttke v. Commissioner,* 72 T.C. 677 (1979), *affirmed,* No. 79-1885 (8th Cir. July 9, 1980). In *Buttke,* the taxpayer sold his farm in March, 1976, in a transaction which was subject to the min-

imum tax law as it *then* existed because of the large amount of capital gain involved. Subsequently, the Tax Reform Act of 1976 retroactively increased the minimum tax burden on the taxpayer in *Buttke.* Arguably, *Buttke* was correctly decided on its facts, since the retroactive changes to the minimum tax made by the Tax Reform Act operated as an increase in tax burden as to the particular taxpayer in *Buttke,* and not as a new tax.[2]

The retroactive imposition of the minimum tax after Appellee sold the triplex brought the sale of Appellee's triplex within the bounds of the separate minimum tax for the first time, that is, imposed a new tax retroactively as to Appellee, and, therefore, such retroactive imposition of tax was arbitrary, harsh and oppressive.

4. CONGRESS AND LOWER COURTS HAVE RECOGNIZED THE HARSHNESS AND OPPRESSIVENESS OF THE RETROACTIVE IMPOSITION OF CERTAIN INCOME TAXES, INCLUDING THE CHANGES TO THE MINIMUM TAX RETROACTIVELY IMPOSED BY THE TAX REFORM ACT OF 1976.

The Tax Reform Act of 1976 contained two retroactive provisions other than the minimum tax changes, a reduction in the exclusion for earned income abroad, and a reduction in the sick pay exclusion, both of which were made retroactive to January 1, 1976.

The earned income abroad exclusion applies to Americans working abroad. Prior to the Tax Reform Act of 1976, the law allowed taxpayers residing in foreign countries to exclude $20,000 to $25,000 of their income earned abroad from United States' taxation. The Tax Reform Act of 1976 reduced the exclusion by $5,000 retroactive to January 1, 1976.

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[2] Other courts have followed *Buttke* rigidly without close consideration of the particular facts in *Buttke. See* Appellant's jurisdictional statement, footnote 8; *Witte v. Commissioner,* T.C. Memo 1980-393 (1980).

Recognizing the harsh effect this retroactive change had on foreign residents, Congress in the Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126, eliminated the retroactive effective date of the provision and delayed its effective date to years beginning after December 31, 1976. The Report of the Senate Finance Committee stated:

> The application of the changes to the earned income exclusion to all income earned by individuals abroad beginning on January 1, 1976, substantially increased the tax burden of many of these taxpayers. Prior to the enactment of the Tax Reform Act of 1976 on October 4, 1976, these individuals did not know that they would be liable for substantially higher taxes and thus many had not saved the money to pay the increased taxes. As a consequence, the changes in the exclusion caused a particular hardship for 1976. S. Rep. No. 95-66, 95th Cong., 1st Sess. (1977).

The second retroactive provision of the Tax Reform Act of 1976 which was amended to apply prospectively only because of congressional concern with the unfairness of its retroactive application involved the sick pay exclusion. The Tax Reform Act of 1976 reduced or eliminated the exclusion of sick pay or disability income from gross income, thus working a hardship on many persons who expected to pay little or no tax on their sick pay or disability income. Recognizing this hardship, Congress in the Tax Reduction and Simplification Act of 1977 eliminated the retroactive effective date of this provision. The Report of the Senate Finance Committee stated:

> Although the Tax Reform Act of 1976 did not become law until October 4, 1976, the revisions in the sick pay exclusion were made applicable back to January 1, 1976. Even though the House version of the Tax Reform Bill, which passed on December 4, 1975, changed the sick pay provision prospectively (by applying the revisions to taxable years beginning after December 31, 1975), most of

> the taxpayers affected by the change were not aware of it. Consequently, many taxpayers were surprised to learn at the end of 1976 or early in 1977, that the sick pay exclusion was not available for 1976. For many of these taxpayers this change meant a large and unexpected final tax payment with their 1976 returns. For many taxpayers retired on disability pensions, such a large unanticipated cash payment represented a serious hardship. The committee believes that individual taxpayers should be given more advance warning when a change of this magnitude is made. S. Rep. No. 95-66, 95th Cong., 1st Sess. (1977).

The question arises as to why Congress did not also eliminate the retroactive effective date provision of the changes made to the minimum tax by the Tax Reform Act of 1976. A possible explanation lies in the observation that Americans living abroad and disabled persons are larger groups which tend to be organized and which are both represented before Congress by effective lobbyists. In any event, Congress subsequently recognized the harshness and oppressiveness of the only other retroactive provisions of the Tax Reform Act of 1976, and amended the provisions to apply prospectively only. Significantly, all of the changes made to the minimum tax by the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2871, were made to apply prospectively only.

Lower courts have specifically recognized the harsh and oppressive effect of applying the changes made to the minimum tax by the Tax Reform Act of 1976 retroactively. In upholding the constitutionality of the changes to the minimum tax made by the Tax Reform Act of 1976, the Tax Court in *Westwick v. Commissioner,* T. C. Memo 1979-329, 38 TCM 1269 (1979), *appeal pending,* No. 79-2245 (10th Cir.), stated:

> Petitioner presented his position with sincerity and eloquence. We can understand his viewpoint. As a Court, however, we must take the law as written . . . [W]e have no choice but to sustain respondent's position. *Westwick v. Commissioner, supra* at 1271.

Similarly in *Buttke*, the Tax Court stated:

> Petitioners allege that the capital gain subject to the minimum tax here was a once-in-a-lifetime gain from the sale of a farm, that they are persons of modest means, and that under these circumstances the tax is harsh and oppressive. *While we are sympathetic with petitioners' plight, in light of the cases in which retroactive taxes have been upheld,* we cannot find the application of this tax "so harsh and oppressive as to transgress the constitutional limitation". *Buttke v. Commissioner,* 72 T.C. 677, CCH Dec. 36,174 at 3630-3631 (1979), *affirmed,* No. 79-1885 (8th Cir. July 9, 1980) (emphasis added).

Based on the special fact pattern in one instance and without complete analysis of the facts in the other, the Tax Court did not rule for the taxpayer in either case. However, in both instances, the Tax Court recognized the harsh and oppressive character of applying the changes to the minimum tax made by the Tax Reform Act of 1976 retroactively.

CONCLUSION

Wherefore, Appellees E. M. and B. L. Darusmont respectfully submit that the minimum tax on tax preferences, as applied to Appellees in 1976, was so harsh and oppressive as to deny Appellees due process of law, and, on the basis that the final judgment of the District Court is obviously correct in its decision to this effect, Appellees respectfully move the Court to affirm the judgment of the District Court for the Eastern District of California.

Respectfully submitted,

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